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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. ..228

UNITED STATES OF AMERICA,
Plaintiff-Respondent,

against

THE MORRIS AND ESSEX RAILROAD COMPANY, CORA DREYFUS, LILLIAN A. NEUBERT and LAURA D. PEPPER,
Defendants-Appellants,

and

THE DELAWARE, LACKAWANNA AND WESTERN RAILROAD COMPANY,
Defendant.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF

FREDERICK M. SCHLATER,
Counsel for Petitioners, The Morris and Essex Railroad Company, Lillian A. Neubert and Laura D. Pepper.

SAMUEL HERSHENSTEIN,
Counsel for Petitioner Cora Dreyfus.

TABLE OF CONTENTS

	PAGE
Petition For Writ of Certiorari	1
Jurisdiction	2
Opinions Below	2
Statement	2
Questions Presented	4
Reasons Why Writ Should Be Granted	5
Brief In Support of Petition	7
Statement	7
Specifications of Error	7
POINT I—Under clear local law the payments from the lessee to the stockholders of the lessor are their sole and absolute property and cannot be appropriated by the Government or any other creditor of the lessor	8
POINT II—Because an income tax may be assessed upon certain income, it does not necessarily follow that the Government may collect the tax from that income	12
POINT III—Stockholders of a corporation are not personally responsible for corporate income taxes	15
POINT IV—In any event the Government may not collect from present stockholders income taxes due by reason of distribution to former stockholders	16
IN CONCLUSION	16

Table of Cases Cited

PAGE

Anderson v. Morris & Essex R. Co., 216 Fed. 83..... 11

Bijur v. Standard Distilling Co., 74 N. J. Eq. 546, 70 A. 934, aff'd 78 N. J. Eq. 582..... 11

Black v. Delaware and Raritan Canal Co., 24 N. J. Eq. 455 11

Bowers v. Interborough Rapid Transit Company (1923), 121 Misc. 250, affirmed 208 App. Div. 768.... 10

Cannon v. Nicholas (10th Circuit), 80 Fed. 2d 934..... 12

Douglas v. Willcuts, 296 U. S. 1..... 12

Erie Railroad v. Tompkins, 304 U. S. 64..... 9

Fleming v. Reed, 77 N. J. L. 563..... 11

Freuler v. Helvering, 291 U. S. 35..... 10

Gifford v. Corrigan, 117 N. Y. 257..... 11

Harwood v. Eaton, 68 Fed. (2d) 12..... 11

Higgins v. Smith, 308 U. S. 473..... 15

Joliet & Chicago R. Co., 86 L. Ed. 658, 315 U. S. 44.... 14

Kyle v. McGuirk (3rd Circuit), 82 Fed. 2d 212..... 12

Lyeth v. Hoey, 305 U. S. 188..... 10

Moline Properties, Inc. v. Commissioner of Internal Revenue, 87 L. Ed. 1071..... 15

Nina H. Peabody v. Interborough Rapid Transit Company, 124 Misc. 801, affirmed 213 App. Div. 857, affirmed (1925) 240 N. Y. 708..... 10

Poe v. Seaborn, 282 U. S. 101..... 10

Price v. United States (1926), 269 U. S. 492..... 9

Seaver v. Ransom, 224 N. Y. 233..... 11

United States v. Warren Railroad Company, 127 Fed. (2d) 134, 137.....2, 3, 9

United States v. Western Union Telegraph Co. (1931) (2d) Circuit, 50 Fed. 2d 102.....9, 11

PAGE

Western Union Telegraph Co. v. Commissioner, 68 Fed. (2d) 16 12

Wilson, et al. v. Moorland Farms Corp., et al., 102 N. J. Eq. 425, 427 11

OTHER AUTHORITIES CITED

26 U. S. C. A. 166, Reg. 103, § 19.167-1 13

26 U. S. C. A., Section 3692 5

26 U. S. C. A., Section 3670 ..... 5, 15

26 U. S. C. A., Section 3690 ..... 5, 15

28 U. S. C. A., Section 347 2

Constitution of the United States, Fifth Amendment .. 5

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Defendants-Appellants,

and

THE DELAWARE, LACKAWANNA AND WESTERN RAILROAD COMPANY,
Defendant.

PETITION FOR WRIT OF CERTIORARI

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioners Morris and Essex Railroad Company, Cora Dreyfus, Lillian A. Neubert and Laura D. Pepper respectively pray that a writ of certiorari issue to the United States Circuit Court of Appeals, Second Circuit, to review a decision of that Court handed down in this cause on May 7, 1943.

Jurisdiction

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. A., Section 347).

Opinions Below

The opinion of the District Court for the Southern District of New York is not officially reported, but is set forth in full in the record (fols. 145-52). The District Court acted on authority of a prior decision of the Circuit Court of Appeals of the Second Circuit, *United States* v. *Warren Railroad Company*, 127 Fed. (2d) 134.

The Circuit Court of Appeals affirmed with a decision handed down May 7, 1943, reported at 135 Fed. (2d) 711 and reproduced in full in the record.

Statement

No fact here is in dispute.

The Government has been granted an injunction restraining the defendant, Delaware, Lackawanna & Western Railroad Company from making any payments to the stockholders of the defendant The Morris and Essex Railroad Company which payments are due to said stockholders, pursuant to an agreement of lease made in 1868, to the end that the Government can collect therefrom income taxes which it claims are due from the corporation, The Morris & Essex Railroad Company.

It is the Government's claim that it can collect income taxes which it claims are due from The Morris and Essex

Railroad Company in the maximum amount of $2,114,084.60 from periodic rental payments due from another corporation to the some 6,000 stockholders of the petitioner The Morris and Essex Railroad Company. The procedure here adopted by the Government was suggested by the Circuit Court of Appeals in *United States* v. *Warren Railroad Company*, 127 Fed. (2d) 134.

In 1868 the petitioner The Morris and Essex Railroad Company leased all of its property for the duration of its charter to the Delaware, Lackawanna & Western Railroad Company in consideration of semi-annual payments to be made directly to the lessor's stockholders and bondholders. The lessee promised to pay the stockholders of the lessor "interest" at 7% per annum on the par value of said stock and 1% contingent additional interest. The latter provision was modified in 1917 to provide that the defendant pay ¾% interest fixed in lieu of the contingent additional interest of 1%. Since 1917, therefore, the interest paid on the stock totals 7¾%. There are now outstanding 300,000 shares of stock held by some 6,000 persons. The total payments made annually by the lessee to the stockholders of the lessor is $1,162,500. The lessee also agreed to pay the bonds and interest thereon and all other obligations due and owing by the lessor. There are now outstanding some $60,000,000 of such bonds held by the public. Upon these the lessee pays a total of $2,400,000 interest per annum directly to the bondholders.

The obligation of the lessee to pay to the stockholders of the lessor is endorsed in writing upon the certificates of stock which are also signed by the lessee.

That contractual endorsement reads in part:

> "• • • The Delaware, Lackawanna & Western Railroad Company, its successors and assigns, shall

> pay to the holders of the capital stock of The Morris & Essex Railroad Company dividends at the rate of seven and three-quarters per cent. per annum (7¾%) upon the par value of said stock * * * all of such payments to be free and clear of all taxes, assessments or impositions whatsoever" (fol. 116).

Under the clear provisions of local law the payments and the right to the payments thus required to be made by the lessee are the sole and absolute property of the stockholders of the lessor.

While the determination below granting an injunction *pendente lite* against the continuance of the payments is not a final determination in a legalistic sense, yet the merits of the controversy have been adjudicated. Further procedure is formal. If the questions here involved are to be reviewed by this Court they should be reviewed now for delay will work serious injuries to the stockholders in the event that it be held that the Government does not have the right to appropriate their property for the satisfaction of the corporation's indebtedness. The 6,000 stockholders, many of them holding a small number of shares, are dependent upon the guaranteed return from this stock for their support and maintenance. Subsequent payment of accumulated distributions will not repair the great damage and hardship occasioned by the withholding of the semi-annual payments (fols. 105-6).

Questions Presented

1. Are stockholders, as such, in the absence of fraud, liable for corporate income taxes, at the option of the Government?

2. Has Congress authorized the Government to collect corporate income taxes assessed against the corporation from its stockholders? (26 U. S. C. A., Secs. 3670, 3690, 3692.) If so, is such authorization contrary to the Fifth Amendment to the Constitution of the United States?

Reasons Why Writ Should Be Granted

1. The decision of the Court below is in conflict with applicable local decisions under which the payments are the sole property of the stockholders.

2. The decision of the Court below is in conflict with applicable decisions of this Court.

3. This is a test case of general importance; there are now pending some nine similar actions involving total annual payments to stockholders of lessor railroads of $2,840,772.

4. Serious hardship and injury will result from the mere withholding of the payments should it later be determined that the Government has no right to collect from present stockholders corporate income taxes assessed by reason of payments made to former stockholders as well as taxes presently accruing.

WHEREFORE your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Court directed to the United States Circuit Court of Appeals for the Second Circuit commanding said Court to certify and send to this Court on a day to be designated a full transcript of the record of all proceedings of the said Circuit Court of Appeals in this cause to the end that this

case may be reviewed and determined by this Court; that the judgments and orders of the said Circuit Court of Appeals for said Circuit be reversed and that petitioners be granted such other and further relief as to this Court may seem just and proper.

THE MORRIS AND ESSEX RAILROAD COMPANY,
LILLIAN A. NEUBERT and LAURA D. PEPPER,

By FREDERICK M. SCHLATER,
Counsel for Petitioners.

CORA DREYFUS,

By SAMUEL HERSHENSTEIN,
Counsel for Petitioner.